In the Supreme Court
OF THE
United States

OCTOBER TERM, 1944

No.

H. M. LORBER, ROY R. DEMPSTER, J. R. MASON, ARTHUR LORBER, FRANCES V. WHEELER, GILBERT MOODY, J. B. BLOOM, as Trustee of the Bloom Company, a Trust Estate, and STANLEY W. LANDIS,
Petitioners,

vs.

VISTA IRRIGATION DISTRICT,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

FACTUAL BACKGROUND OF THE CASE.

Some of the facts are stated under the heading "Summary Statement of the Matter Involved" in the accompanying petition. There is also a statement of

some of the facts in the opinions of the Court below (R. 64, 472), 127 Fed. (2d) 628, 143 Fed. (2d) 282.

The Vista Irrigation District,[1] respondent here, is a state governmental agency organized August 28, 1923 and located in the County of San Diego. It comprises 18,309 acres. (R. 41.) The principal crops of its taxpayers consist of citrus fruits and avocados, although there is a wide variety of other horticultural planting. Many of its residents make their living in San Diego and Los Angeles and commute there over the weekend, maintaining caretakers. They live in the district for residential reasons and not for farming purposes. Even during the depression there has been an uninterrupted tremendous increase in population and building within the district, from 646 homes in 1933 to 1615 homes in 1941.

Despite the slump and the technical default in payment of its obligations, lands have continued to sell in that district at enormous prices. Some 14,600 acres are watered—in other words, have a domestic and irrigation water supply. (R. 41.) Planted avocado groves are worth $200 to $700 an acre (R. 410); Valencias $500 an acre; Lemons $600 to $650. Land has been bought and sold every year. Unimproved land is bringing $500 an acre. (R. 149.) One of the debtor's witnesses put the value of raw land with water at an average of $250 to $300 an acre. (R. 150.) One land company is holding eight tracts of land at $1250 an acre. (R. 153.)

[1]Herein called the "district".

In 1925 the district voted and sold general obligation 6% gold coupon bonds in the amount of $1,700,000 due serially from 1946 to 1965 and bearing six per cent interest. The bonds are non-callable. It will be observed none of these bonds are yet due, so that the technical default was only partial and as to interest, and as a matter of fact the bankruptcy petition failed to allege insolvency or even past due indebtedness. (R. 3.) The district obtained a loan from the R.F.C. in 1935 in the amount of $937,500 to refinance its indebtedness. (R. 4.) In brief, this provided a cash payment of 55 cents on each dollar of bond principal plus a certain adjustment of interest. (R. 10.)

When the first municipal bankruptcy act was held unconstitutional, the district's petition was dismissed and subsequently some of the petitioners here obtained State Court judgments (R. 51) and pleaded them in their answer to the bankruptcy petition. (R. 22, 27, 31.)

The original bondholders through the medium of an escrow agreement (R. 121) delivered their bonds to the bank with instructions "to deliver (the bonds) to the treasurer of said district upon receipt * * *" of the money. (R. 121.) The instructions further recited "it is further understood and agreed that title to the deposited bonds, coupons and/or tokens shall pass from me to Vista Irrigation District, or its order, * * *" It is contended that since this escrow provision was carried out, title to the bonds acquired at the 55 cent figure passed to the district itself, and it thereby became the legal holder, and so could not count such indebtedness as consenting bonds by subse-

quent transfer of the surrendered securities to the R.F.C.

One of the judgments obtained by the petitioners herein contains this adjudication: "That the outstanding bondholders of respondent irrigation district are bondholders holding not to exceed $68,000 of bonds of said district, including those of petitioners, and also the Reconstruction Finance Corporation of the United States, who holds all of the other bonds of said district as collateral security for a loan to said district, and that all amounts due to the Reconstruction Finance Corporation prior to January 1, 1937, have been paid." (R. 30.)

The petitioners own approximately $37,000 principal amount of original 6% bonds. Substantially all the other bonds have been liquidated and under no circumstances could they now be revived. They are cancelled.

None of the original bonds of this district were redeemable and none mature before the year 1946. There has been default only in payment of interest. Interest was paid to January 1, 1933. In 1932 93% of the bondholders voluntarily offered a five year adjustment, reducing bond interest from 6% to 2%. During 1933 to 1938 $190,000 in interest, approximately, was paid. The district erroneously claimed $375,000 of interest unpaid and showed no credit in its calculations for the $120 interest per bond, previously waived. At the time of the hearing in the Court below, the district had available to pay creditors $238,000 in cash, and during the period since getting the R.F.C. loan has made capital investments of $150,000, approximately. If, therefore, $375,000 interest (as a maximum) was in arrears and

the district had expended $150,000 in capital investment, and had on hand $230,000 cash, the Court manifestly erred in ruling the district insolvent or unable to pay its debts.

On the question of tax collections, also, the record shows a most favorable condition. (R. 276-281.) The district has actually collected 7% more than the total taxes which it had levied. Under California law, 15% is levied over and above actual budget requirements in anticipation of tax delinquencies. The district has actually collected 107% of its annual levy.

The testimony of the district's witnesses at the hearing showed the taxable land in the district was currently salable for $500 an acre unimproved, and an asking price of as high as $1250, whereas the total original bonded debt only averaged $92 an acre. The capital investments within the district are approximately $13,500,000. The irrigated land is rich and highly developed, and is also valuable for homesites. The district is clearly neither insolvent nor unable to pay its lawful debts.

The judgment rendered November 29, 1937, in the case of *Schubert v. Vista Irrigation District* (R. 22, 25), adjudged that "there is no other outstanding indebtedness of said respondent district which has matured except only interest due upon bonds of said district amounting to not to exceed $33,000.00, being interest at 6% per annum, which became payable January 1, 1937 and July 1, 1937; that as the respondents have on hand funds available for application to payment in full of the said matured coupons and interest of the petitioners, the respondents be not

required to levy any further assessment during the year 1937." (R. 25.) The bankruptcy petition was filed March 26, 1938. (R. 13.)

In other words, all the district then owed was the 1938 interest. The Bankruptcy Court surely was bound by this judgment and it is *res judicata,* and therefore the finding of the trial judge is incorrect when he decreed that the district is insolvent.

However, approaching the matter from a different angle, the district had on hand December 31, 1938, cash in the amount of $229,830.46. (R. 241.) It has assets consisting of permanent capital improvement by the district in the amount of $1,684,341.35. (R. 394.) It has title to over 900 acres of tax-escheated land of the value of $68,752.78. (R. 277.) Tax certificates owned by the district in the amount of $87,551.12 (R. 273) and receivables on land sale contracts amounting to $33,585.11. (R. 281.) It has expended for new construction the sum of $178,111.33. (R. 244.) It has paid off overlapping bond debt of $17,585.67. (R. 244.) It purchased its own unmatured bonds, using $11,000. (R. 244.)[2]

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[2]The total current assets which were available to pay the current interest balance, which is claimed to be $375,000 are thus seen to be:

Cash	$229,830.46
Land for sale	68,752.78
Tax sale certificates	87,551.12
Receivables on contracts	33,585.11
New construction	178,111.33
Bonds purchased	11,000.00
Bonds paid off	17,585.67
Total	$626,416.47

This says nothing of taxable land values, or assessment values or capital assets.

The greatest amount lawfully due on the coupons in 6 years from 1933 to 1938 was $185,423.44, this by reason of the fact that 93% of the bondholders had voluntarily waived $120 a bond interest, but if they had not waived this amount the total interest would have been $375,000 and the district would still have been perfectly solvent. The Court found the bond interest of 1933-38 to be $375,143.44 and it has already been pointed out that the bonds all mature from and after 1946. (R. 43.) The assessed value of the taxable real property in the district is $2,022,069.20. (R. 290.) It has invested $1,851,000 in physical utilities, water pipelines, buildings, reservoirs and equipment. (R. 304.) It has a surplus of $737,000 (R. 304) and the real property within the district is appraised at $13,435,821.55. (R. 395.)

For the years 1931 to 1938, the tax delinquency, after applying credit for the tax certificates sold or redeemed and tax-escheated property resold was only 8.29%, whereas the state law makes it mandatory for the district to levy $115 as taxes for every $100 required by the annual budget, so that during the years 1931 to 1938 the district actually collected 7% more money than its actual budget called for.

The district renegotiated its water contract and thereby affected a saving of $659,399.12. (R. 296.) The delinquency in the collection of water tolls is only 1.7%. (R. 299, 301.) Only $20,000 a year will be needed in the way of capital investment to put and keep the entire water distributing system of the district into first-class shape. (R. 299, 436.)

Certain judgments were obtained by the petitioners. One of these (R. 23) dated November 29, 1937, adjudged that there was no other outstanding indebtedness of the district except $2640 due petitioners and $33,000 or less as bond interest for 1937, and that the district then had funds available to pay its default in full. The judgment then adjudged that the district and its officers "in the year 1938 and each year thereafter, all as provided in Section 39 of the California Irrigation District Act, levy an assessment upon all the lands within the boundaries of the Vista Irrigation District,". The Court issued a peremptory writ of mandate and adjudged "that the court retain jurisdiction of this case for the purpose of requiring the respondents or their successors in office to levy and collect the assessments herein provided and to pay the same to petitioners or their assigns". The petitioners contend that the matters adjudged in this case are of such scope as to establish proof of solvency and to prevent this Court, the Bankruptcy Court, from interfering with the governmental and political affairs of the state where exercised through the State Court rendering this decision. (*U. S. v. Bekins,* 304 U. S. 27, 58 S. Ct. 811; *Oklahoma v. Texas,* 256 U. S. 70; *Adirondack Railway v. New York,* 176 U. S. 335.) When the judgment in question was rendered November 29, 1937 (R. 27) the present amended municipal bankruptcy act was in effect (August 16, 1937) (50 Stat. 654), and the plan had long been proposed and largely carried out. How can the Court below annul that State Court judgment?

For detailed facts and figures evidencing the solvent and flourishing condition of this district, see the bond circular of the bankers who recently sold the new 3¼% refunding bonds. (R. 451-456.)

The case was reheard by the trial judge after remand on December 8, 1942 and certain evidence brought down to date. The district judge made findings supporting his conclusion that 55 cents is all the district court "reasonably be expected to pay". The cause was then certified back to the Circuit Court of Appeals.

During the interim, however, and outside of and undisclosed to the Court, the district accepted an offer for new refunding 3¼% bonds in the amount of $780,000, due serially from January 1, 1944 to January 1, 1971, and sold these 3¼% bonds to Blyth & Co., Stone and Youngberg, and other underwriters, which in turn sold the 3¼% bonds above par and accrued interest, and with the proceeds of this new 3¼% bond issue and certain other funds the respondent liquidated and entirely paid off the R.F.C. by paying the R.F.C. $651,527.54, thus retiring and cancelling the original bond indebtedness upon the existence of which the bankruptcy proceeding depended. No reservations of any kind were made. The consenting bond debt was simply wiped out and new 3¼% bonds issued in the amount of $780,000. (R. 448.)

The plan of composition provided for 4% refunding bonds in the amount of $937,500, to be issued to the R.F.C. (R. 9.) The refunding bond issue is at 3¼%, and the R.F.C. did not get any bonds.

The plan was abandoned by respondent. The old debt is refunded and is liquidated. The consent of bondholders to the plan of composition, the only foundation for the consent, is completely liquidated and wiped out. The whole proceeding is now moot. In the light of this state of affairs, the petitioners made a motion before the Circuit Court of Appeals requesting dismissal of the whole proceeding. (R. 443.) This motion was denied.

The interlocutory decree was confirmed.

Our petition for a rehearing was denied.

ARGUMENT.

FIRST POINT AND SECOND POINT: I. WHERE THE STATE COURT, IN ITS JUDGMENT RENDERED NOVEMBER 29, 1937, DIRECTED PUBLIC OFFICIALS OF THE STATE TO MAKE ANNUAL DIRECT AD VALOREM TAX LEVIES FOR THE DISCHARGE OF A PUBLIC DEBT, AND SPECIFICALLY RETAINED JURISDICTION OF THE CAUSE FOR THE PURPOSE OF REQUIRING THE OFFICIALS TO LEVY AND COLLECT THE TAXES, IS NOT A BANKRUPTCY DECREE WHICH RESTRAINS AND ANNULS ENFORCEMENT OF THAT JUDGMENT, AN INTERFERENCE WITH THE GOVERNMENTAL AND POLITICAL AFFAIRS OF THE STATE, PROHIBITED BY SECTION 83(c) OF THE BANKRUPTCY ACT?

II. WHERE THE STATE COURT IN 1937 DETERMINED THE RELATIONSHIP OF THE R.F.C. TO THE BANKRUPT AND TO THE PETITIONERS BY FINAL JUDGMENT, AND THEREIN DETERMINED THE R.F.C. HOLDS THE ORIGINAL BONDS "AS COLLATERAL SECURITY FOR A LOAN" AND THAT THE LOAN HAS BEEN PAID AS TO ALL OBLIGATIONS UP TO JANUARY 1, 1937, AND THAT THE DISTRICT HAS FUNDS TO PAY ITS DEBTS, IS NOT THE PLEA OF RES JUDICATA AVAILABLE IN A BANKRUPTCY COURT SO AS TO LIMIT THE CLAIM OF THE R.F.C. TO THE AMOUNT OF THE LOAN, AND TO MAKE ITS CONSENT AS HOLDER FOR FULL FACE VALUE OF THE ORIGINAL OBLIGATION A NULLITY?

As pointed out in the statement of factual background of the case (supra), the Superior Court of the State of California rendered several judgments wherein it adjudged that the district had no matured debt for which it did not have available funds to pay. This judgment was rendered after the enactment of the present bankruptcy act and long after the plan of composition was carried out to its present extent. In fact the decision of the Court is based upon the fact that the plan of composition had been carried out to such an extent as to eliminate a large portion

of the original indebtedness. This judgment we maintain is binding on the Bankruptcy Court and eliminates any possible finding of insolvency or inability to pay. Furthermore, it may be said that the Superior Court in rendering judgment was not unmindful of the bankruptcy proceeding, and its judgment was made in view of the possibility of a renewed attack upon petitioners here in the Bankruptcy Court. It flatly determined that it should retain jurisdiction of the public officers of the state and require them from year to year to levy assessments to pay petitioners' bonds. We respectfully submit that the Circuit Court erred in utterly disregarding and overruling these State Court judgments; the decree of the Bankruptcy Court interferes with the sovereign powers of the State of California to the extent of annulling its judgments and in effect directing its officers to levy assessments and collect taxes contrary thereto.

THIRD POINT: WHERE THE ORIGINAL CREDITORS SURRENDERED THEIR BONDS FOR THE ACCOUNT OR ORDER OF THE BANKRUPT UPON PAYMENT BEING RECEIVED FROM FUNDS LOANED BY THE R.F.C., ARE NOT THE ORIGINAL SECURITIES OWNED AND HELD BY THE BANKRUPT, SO AS TO PREVENT THEIR BEING COUNTED IN THE CONSENT, ESPECIALLY IN VIEW OF THE PLEA OF RES JUDICATA?

As shown in the recital of facts, the escrow instructions by which the original bondholders deposited and sold their bonds provided that the bondholders transferred title upon payment for their bonds directly to the irrigation district. It is submitted that the irriga-

tion district thus becomes the owner and holder of these bonds and that it could not apply for the benefits of the bankruptcy act as to them nor could it nor is it authorized to subsequently transfer title to such bonds to a third party for the purpose of enabling that third party to file a bankruptcy petition. (11 U.S.C.A. 403 (d).)

FOURTH POINT: IS A PLAN OF COMPOSITION FAIR WHERE LANDS WITHIN THE TAXING AGENCY HAVE ON THE MARKET VALUES VASTLY IN EXCESS OF THE DEBT, WHERE THE TAXPAYERS HAVE INDEPENDENT MEANS AND THE EVIDENCE SHOWS A STEADY GREAT INCREASE IN POPULATION?

The assessed value of the bare land without the improvements in this district amounts to $2,000,000; the bonded indebtedness sought to be composed was $1,700,000; the capital investment in this district is over $13,500,000; approximately 15,000 acres of the land in this district are worth in excess of $500 an acre or over $7,500,000; these lands are readily salable at the present time in spite of testimony about soil conditions at figures varying from $100 minimum for raw, unimproved land to $1250 for good orchards per acre. A great many of the homes in this district are held by persons who work in San Diego and own places and commute or come out over the weekend, leaving caretakers to take care of their estates. The trial Court's own finding confirms our point. "That while it is true that the number of homes in said district has increased from 646 in 1933 to 1615 homes in 1941, the majority of the persons owning said homes reside therein only over the weekend and obtain their

livelihood from other resources than the groves which they own, and that but very few of them earn their living from such groves." (R. 436.)

FIFTH POINT: IS A PLAN OF COMPOSITION FAIR WHICH ALLOWS ONE CREDITOR 100% OF HIS INVESTMENT IN BONDS BEARING INTEREST AT 4%, WHICH BONDS ARE VERY DESIRABLE SECURITY ON THE PRESENT DAY MARKET, WHILE IT REQUIRES PETITIONERS TO SURRENDER THEIR BONDS AND TAKE CASH?

There is a direct conflict between the decisions of the Ninth Circuit Court of Appeals and the decisions of the Fifth Circuit Court of Appeals on the question of whether a plan of composition which affords to one creditor bonds but denies those bonds to another creditor is fair. In the Ninth Circuit the decisions of the Court have held that there is no unfairness. (The instant case, and also *West Coast Life Ins. Co. v. Merced Irrigation District,* 114 Fed. (2d) 654.) On the other hand, in the Fifth Circuit in *State of Texas v. Tobasco Consolidated School Dist.,* 132 Fed. (2d) 62, 133 Fed. (2d) 196, 142 Fed. (2d) 58, the Court squarely held that such a plan is unfair.

As a matter of equity it must be so. These and similar four per cent tax exempt bonds are selling at enormous premiums on the market. The bonds of most of the districts whose plans of refinancing by 4% bonds were approved by the Ninth Circuit Court of Appeals are selling on the market to yield less than 3%, making big profits for the R.F.C. and its inside broker friends. It is respectfully submitted that it is grossly unfair to permit one creditor to receive these

bonds for the full amount of his investment and that another be required to take 55 cents in cash.

SIXTH POINT: WHERE THE BANKRUPT BORROWED MONEY FROM THE R.F.C. ON THE SECURITY OF ORIGINAL BONDS REPRESENTING THE INDEBTEDNESS TO BE COMPOSED, AND DURING THE PROCEEDINGS BUT BEFORE THE INTERLOCUTORY DECREE BECAME FINAL, THE BANKRUPT PAID THE R.F.C. IN FULL AND LIQUIDATED THE ORIGINAL INDEBTEDNESS WITH NEW MONEY BORROWED FROM PRIVATE BANKERS, IS NOT THE CASE MOOT, AND IS THERE NOT A FAILURE OF CONSENT OF THE MAJORITY BONDHOLDERS, AND SHOULD NOT THE WHOLE PROCEEDING BE SET ASIDE AND DISMISSED? IF NOT DISMISSED, DOES NOT THE SAVING MADE BY THE 3¼% BONDS BELONG TO THE CREDITORS?

When the Municipal Bankruptcy Act was re-enacted it was on the basis and theory of providing a Court procedure by which there could be a binding judgment upon the creditors, but the public debtor could never be bound until after it put up the consideration with the Court and had executed the plan. In consequence an interlocutory decree at most is only binding upon the consenting creditors. It merely gives an option to the debtor. There is no requirement that the debtor should put up the consideration and the debtor is at liberty to violate and abandon the whole plan, even after the entry of the interlocutory decree. It is only by the final decree that the discharge is granted and the composition plan is finally put into effect and confirmed. In the instant case the district, even before the interlocutory decree became final, and while it was on appeal, negotiated with private money lenders for a new loan of $780,000 at 3¼% interest, paid off

the R.F.C. and entirely liquidated the bonds upon which the consent was based and in fact, entirely liquidated the indebtedness involved in the bankruptcy proceeding. There is of course nothing to prevent a bankrupt from taking advantage of new and cheaper money, but we respectfully submit that when as here the debtor cancels and pays off the original indebtedness during the proceedings the debtor thereby renders the cause moot. The proceedings, we submit, should have been dismissed by the Circuit Court of Appeals upon the motion therefor by the petitioners. It is respectfully submitted further that the jurisdiction of the Court depended upon the consent of the creditors holding the original bonds, and in no sense can such consent survive the cancellation of the original bonds. The only cases which we have been able to find in other Circuits in any way construing this point are *Wright v. Coral Gables,* 137 Fed. (2d) 192, affirmed March 13, 1944, 64 S. Ct. 779, 321 U. S. 753, and the case of *Green v. City of Stewart,* 135 Fed. (2d) 33.

CONCLUSION.

It is submitted that a writ of certiorari should be granted, the decree of the Court below reversed and the proceedings directed to be dismissed.

Dated, Turlock, California,
October 16, 1944.

W. COBURN COOK,
Counsel for Petitioners.